United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

ORIGINAL

74-1462

To be argued by
MICHAEL BERMAN

In The

United States Court of Appeals

For The Second Circuit

In the Matter of

MELVIN LICHT,

Bankrupt.

MELVIN LICHT,

Appellant,

vs.

HERBERT L. ASH, as Trustee in Bankruptcy of the Estate of Melvin Licht, Bankrupt,

Appellee.

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PRELIMINARY STATEMENT

This is an appeal from a memorandum and order made by the Hon. Mark A. Costantino, one of the judges of the United States District Court, Eastern District of New York, on February 14, 1974, which affirmed the decision and order of Referee in Bankruptcy Manuel J. Price, denying the bankrupt's discharge.

STATEMENT OF ISSUES

The issues presented on appeal are as follows:

1. Should the Referee in Bankruptcy have permitted the trustee to amend a specification which was insufficient as a matter of law after all of the testimony had been adduced, the hearings concluded and briefs submitted by the parties? (Specification "1(b)")

2. Should the Referee in Bankruptcy have permitted the trustee to add an entirely new and different specification, to wit, specification "2(g)", after all the testimony had been adduced, the hearings terminated and briefs submitted by all the parties?

3. Was the evidence offered in support of specification "1(b)", sufficient?

4. Was the evidence offered in support of specification "2(g)", sufficient?

STATEMENT OF THE CASE

The trustee in bankruptcy filed specifications of objections to the bankrupt's discharge, consisting of 15 separate grounds for barring his discharge.

Extensive hearings were held on these specifi-

cations and after all the testimony had been adduced, the hearings concluded and briefs submitted by the parties to the court for decision, the trustee moved to amend the specifications.

This application was made by the trustee because it appeared from the brief submitted on behalf of the bankrupt, that the trustee had made serious errors of law in alleging the facts constituting the specifications and now sought to correct these errors by adding new specifications, although the time within which to file specifications had long elapsed.

The time to file specifications by order made by the Referee in Bankruptcy expired on September 13, 1967 and was extended by the bankruptcy court from time to time until March 5, 1970, two and one-half years thereafter, when the original specifications were filed by the trustee.

The hearings on the discharge of the bankrupt commenced in June, 1972 and were continued and completed in August, 1972.

After the submission of briefs, the trustee moved to amend specification "1(b)" by adding the word "fraudulently" to the allegations set forth in "1(b)".

Specification "1(b)", as sought to be amended,

alleged as follows:

> "1. The bankrupt has committed an offense punishable by imprisonment as provided by 'Title 18, United States Code, Section 152, in that the bankrupt ***
>
> (b) In contemplation of the bankruptcy proceeding of John Licht, Inc., knowingly transferred to himself property of John Licht, Inc., to wit, ***'". (* A 5)

The allegations set forth in specification "1(b)" are insufficient as a matter of law, to set forth a specification of objection which would bar a bankrupt's discharge. The trustee failed to allege that the transfer made by the bankrupt was "fraudulently" and knowingly transferred.

The trustee having alleged the original specification in 1970, now, two years thereafter, sought to correct the legally insufficient allegation.

The trustee also sought to add a new and different specification in place of specification "2(g)". The specification as originally filed on March 5, 1970, alleged as follows:

> "2. The bankrupt has committed an offense punishable by imprisonment as provided under Title 18, United States Code, Section 152, in that, in contemplation of the filing of the bankruptcy of John Licht, Inc., the bankrupt knowingly and fraudulently falsified or made a false entry in documents affecting or relating to the property or affairs of the said John Licht, Inc., to wit,: ***

*Reference is to Appendix

(g) Entries were made in the books of John Licht, Inc. representing the returns of merchandise to said Company, none of which was actually received by it." (A 5)

This specification alleges that the offense was done in contemplation of the filing of the bankruptcy of John Licht, Inc.

The trustee sought to amend the specifications by adding a new specification which alleged that the offense charged was done after the filing of a bankruptcy proceeding by John Licht, Inc. and in contemplation thereof.

The Referee, in his decision, granted the application to amend both specifications. (A 262)

The Referee, in his decision, dismissed 13 of the 15 specifications alleged and sustained the 2 specifications that he had permitted the trustee to amend. (A 296)

It is the appellant's contention that the Referee was in error in permitting the trustee to amend specifications. If the specifications had not been amended, the bankrupt would have been granted his discharge.

ARGUMENT

POINT I

THE APPLICATION TO AMEND SPECIFICATION "1b" SHOULD HAVE BEEN DENIED FOR LACK OF DILIGENCE

The right to amend specifications is not absolute. Generally amendments will be allowed to correct errors, but an application must be made with due diligence and before the case is submitted to the Court.

The general rule is set forth in 1A Collier on Bankruptcy, 14th Ed., ¶ 14.07, p. 1295:

> "Amendments to correct errors committed by mistake or accident are usually allowed if asked at any time prior to the submission of the case, but application by the objecting party for leave to amend the specifications must be made with due diligence." (emphasis added)

The facts of this case show that the specifications were filed on March 5, 1970. The information upon which the specifications were based was elicited in 21a examinations during 1967 and 1968. There have been no new revelations of information which afforded the trustee the basis for this motion.

It is the contention of the bankrupt that this application by the trustee, after the case had been submit-

ted to the Court, lacked due diligence. In Stanley's Incorporated Store No. 3 v. Earl, 28 F.2d 611, (8th Cir., 1928), an objecting creditor sought leave to file amended specifications one month after the last day had expired. The complained-of acts had occurred four years before. The Court noted that "the exercise of proper diligence" could have brought the true facts to the creditor's attention and denied the relief, stating that the "record show[s] no good cause for the enlargement of the time for filing the specifications." (p. 611)

In In re Grossberg, 11 F.2d 329 (S.D. Fla. 1926), objecting creditors filed general specifications but failed to set forth any of the required property descriptions. The excuse was that the information had only recently been discovered. The Court noted that the creditor had never applied to amend the specifications to assert the required names and descriptions of the properties. In striking the specifications, the Court said:

> "Diligence should be exercised by objecting creditors. This is not apparent in this case, and any leave to amend said specifications will be denied." (p. 331)

There is no question that the trustee's motion came after the case had been submitted to the Court. This is so, even though the information was available to the trustee

for almost three years before he filed his specifications. A motion to amend at this stage of the proceedings does not "manifest an attempt of the creditor to specify" with proper diligence. In re Hixon, 93 Fed. 440 (S.D. Iowa, 1899), p. 443.

The application to amend specification "1b" had not been made with the requisite diligence and should have been denied.

POINT II

THE TRUSTEE SOUGHT TO ADD A NEW SPECIFICATION IN PLACE OF "2g"

The law is clear that a new specification may not be added after the time to file specifications has expired.

General Order 32, states the time requirements for opposing a bankrupt's discharge. It provides as follows:

> "Any person opposing a discharge shall, on or before the time fixed for the filing of objections to the discharge, file a specification in writing of the grounds of his opposition."

It is apparent from the wording of General Order 32, that the basic charges against the bankrupt's dis-

charge must be filed within the time fixed by the Court. Once this date has expired, in the absence of discovery of new evidence which was concealed by the bankrupt, new specifications of objection may not be filed. See Richey v. Ashton, 143 F2d 442 (9th Cir., 1944). In the case at bar the trustee made no claim of discovery of new evidence. On the contrary, the underlying facts were revealed to the trustee in 21a examinations the month following adjudication in July, 1967.

Certainly the trustee cannot claim that he lacked sufficient time to comply with General Order 32. The original order made by this Court under Section 14b(1), set September 13, 1967 as the last day for the filing of objections to the discharge of the bankrupt. The trustee then made liberal use of the last sentence of Section 14b(1) to obtain many extensions of that date. Finally, on March 5, 1970, the trustee filed his specifications of objections to the bankrupt's discharge. This was two and one-half years after the original date set by the Court.

One of the procedural requirements in connection with bankruptcy discharges is that no new grounds of objection may be asserted once the final date for filing specifications has passed. Collier aptly sets forth the rule as follows:

> "Additional grounds of objection may not be added to specifications after the time fixed in the order for filing specifications has expired, unless the court first grants an extension of time, the bankrupt has fraudulently concealed facts until that time, or the grounds would be sufficient for a revocation of the discharge." 1A Collier on Bankruptcy, 14th Ed., ¶ 14.07, pp. 1297-1298.

In the case at bar, there were no fraudulently concealed facts nor are there grounds which could revoke a discharge. The trustee has not claimed any, nor are there any in fact. The other exception cited by Collier, is an extension of time. This was obtained by the trustee, so the time fixed for filing specifications of objections under General Order 32, must be taken as the date of the last extension, to wit, March, 1970.

In In re Hurowitz, 14 F.Supp. 71 (D.C.Mass., 1935), an objecting creditor opposed the bankrupt's discharge. Over the bankrupt's opposition, the referee allowed the creditor to file "substituted specifications which set forth new grounds of objections wholly distinct from those originally specified." (p. 71,emphasis added). The referee denied the discharge based solely on the additional specifications. The district court upheld the bankrupt's position by reversing the referee's reliance on the additional specifi-

cations and granting the discharge.

> "[I]t would seem to be improper to allow a creditor to circumvent the avowed purposes of the act by setting up, in an amendment, grounds of objection which were in no way related to any of the grounds set out in the original specifications." (p. 71)

In another district court case, In re De Cillis, 83 F.Supp. 802 (D.C.Mass., 1949), the trustee alleged only the bankrupt's failure to satisfactorily explain his losses as a basis for opposing the discharge. The referee never considered this issue but denied the discharge anyway, basing his decision on a prior bankruptcy proceeding involving the same bankrupt. The district court had no trouble in reversing the referee, since the ground was not specified in the objection to discharge.

> "It seems to be well settled that new and additional grounds of objections may not be added to specifications after the time fixed in the order for filing specifications has expired.... Consequently, the ground upon which the referee denied the discharge was improperly considered and the referee could not deny the discharge on this unalleged specification." (p. 803)

The pioneer decision in this area is In re Johnson, 192 Fed.356 (D.C.S.D., 1911), in which an objecting creditor sought to file amended specifications over a

year after he filed his original specifications. The court determined that although the amendment was made in good faith, it alleged a new issue which was not included in the original specifications. The amendment "sets out entirely new matter constituting an additional, separate, and independent objection to the discharge of the bankrupt." (p.358)

The court considered the importance of a creditor's right to object to a discharge but still denied the right to introduce new grounds after the last day for filing had expired. The court also differentiated between an amendmend which clarifies something already alleged in the original specifications and a so-called amendment which alleges a new claim.

> "An amendment to these objections that serves the purpose of amplifying, making more definite, or making specific the objections that have been filed, objections of which the original objections gave due notice, simply an amendment to make this effective should in my judgment be allowed at any stage of the proceedings. I can find no authority, however, for the exercise of a discretion, or that discretion is vested in the court, authorizing an amendment of this kind, raising a new issue, at this stage of these proceedings." (p. 358)

The Second Circuit has reached a similar conclusion. In Northeastern Real Estate Securities Corporation v. Goldstein, 91 F.2d 942 (2nd Cir., 1937), the court

was confronted with an objecting creditor who sought to amend his specifications which had already been filed. There were several proposed amendments. The district court allowed those amendments which amplified the original objections, but denied those amendments which introduced new objections.

The Circuit Court of Appeals affirmed in a per curiam opinion. It distinguished between an amendment which made previously filed objections more definite and one which sought to present an additional objection. "But, if he adds a new objection, it is not properly an amendment." (p. 943)

The Northeastern case has been cited as authority for disallowing amendments which seek to allege new grounds of objection. In In re Biro 107 F.2d 386 (2nd Cir., 1939), the court struck out two amended specifications which constituted new objections.

> "The third specification alleged the making of a false oath as to which the original specifications contained nothing and so was not a permissible amendment." (p. 387)

The fourth specification was a general allegation of embezzlement.

> "Had the sort of embezzlement which is an offense under the Bankruptcy Act been alleged in the specification, it would still have been subject to exception as new matter under the rule of Northeastern Real Estate S. Corp. v.

Goldstein, supra." (p. 388, emphasis added)

In accord: In re Siegel, 55 F.Supp. 709 (E.D.N.Y., 1944), citing Northeastern as authority for setting guidelines for permissible amendments of specifications.

The law is very clear that no new specifications may be alleged after the date fixed by the court under General Order 32 has expired.

POINT III

THE AMENDMENT OF SPECIFICATION "2" TO INCLUDE "AFTER THE FILING OF THE BANKRUPTCY PROCEEDING OF JOHN LICHT, INC.", CREATED A NEW, INDEPENDENT SPECIFICATION

The second specification alleged by the trustee is based on the seventh paragraph of 18 U.S.C. ¶ 152, which reads as follows:

> "Whoever, after filing of a bankruptcy proceeding or in contemplation thereof, knowingly and fraudulently conceals, destroys, mutilates, falsifies, or makes a false entry in any document affecting or relating to the property or affairs of a bankrupt; ***."

The plain meaning of this paragraph is that its application is disjunctive. An allegation can be (1)

after the filing, (2) in contemplation of the filing, or (3) include both in the alternative. Each of these three allegations comprises a separate, distinct allegation. They do not depend upon each other for sufficiency.

Thus, a specification can allege that under paragraph seven of 18 U.S.C. ¶ 152, the bankrupt committed certain acts in contemplation of a bankruptcy proceeding. This is the nature of the specifications filed herein in March, 1970. There is no question that the limiting of the time period to "in contemplation", does not render the allegation insufficient.

Likewise, a specification could allege that under paragraph seven of 18 U.S.C. ¶ 152, the bankrupt committed certain acts after the filing of a bankruptcy proceeding. No objection could be validly made that the specification was deficient because it confined the time period to after the filing of a petition.

It is apparent from the wording of 18 U.S.C. ¶ 152, paragraph seven, that it can give rise to two separate, distinct specifications, to wit, (a) before the filing of a petition and (b) after the filing of a petition. It is equally apparent that an allegation which contains only one

of these elements which is then changed by the addition of the other element, presents a wholly new specification.

When the seventh paragraph of 18 U.S.C. ¶ 152 is alleged in the alternative, (i.e., after a filing or in comtemplation thereof), it gives the objectant a two-edged sword in that he can claim that acts may have been done at both times. But when the objectant pleads only one of the time periods, he is so limited, and any addition of the remaining time period results in a completely new and independent specification.

POINT IV

THE FEDERAL RULES OF CIVIL PROCEDURE APPLY TO BANKRUPTCY PROCEEDINGS ONLY WHEN SUCH APPLICATION IS NOT INCONSISTENT WITH THE BANKRUPTCY ACT OR GENERAL ORDERS

There is no doubt that the Federal Rules of Civil Procedure apply generally to bankruptcy proceedings. General Order 37, provides as follows:

> "In proceedings under the Act the Rules of Civil Procedure for the District Courts of the United States shall, in so far as they are not inconsistent with the Act or with these general orders, be followed

> as nearly as may be. But the court may shorten the limitations of time prescribed so as to expedite hearings, and may otherwise modify the rules for the preparation on hearing of any particular proceeding." (emphasis added)

Thus, the application of the provisions of the Federal Rules is not absolute. When there is a discernible inconsistency the Bankruptcy Act and General Orders take precedence over the Federal Rules. "The Federal Rules of Civil Procedure must give way when they, or portions thereof, are inconsistent with express provisions of the Bankruptcy Act." In re Shulund, 210 F.Supp. 195 (D. Montana, 1962), p. 189. " The Federal Rules of Civil Procedure were not intended to modify the provision of the Bankruptcy Act and are applicable only when they are not inconsistent with the Act." In re Cardinal Service Corporation, 175 F.Supp. 47 (S.D.N.Y., 1959), p. 49, (emphasis added). In accord: United States v. Verrier, 179 F.Supp. 336 (D.Maine, 1959): In re Atlas Sewing Centers, Inc., 336 F.Supp. 684 (S.D.Fla., 1972).

The trustee cited Rule 15(b) of the Federal Rules of Civil Practice Procedure as a basis to amend the second specification by alleging that certain acts occurred after the filing of a bankruptcy petition.

It has been established that under General Order

32, specifications of objections must be filed on or before the time fixed by the Court for that purpose. There is no question that in this case the original time was extended for two and one-half years and that the time fixed by the court was that of the last extension order obtained by the trustee (i.e., March, 1970).

The trustee, over two and one-half years after the day for filing specifications had expired, and after the Referee had heard testimony and after the parties had submitted their main and reply memoranda, in essence obtained leave to add a separate specification.

Therefore, the granting of the trustee's motion put Rule 15(b) in direct conflict with General Order 32. It allowed the filing of a new specification over two and one-half years after the date specified by General Order 32. In light of the explicit requirement of General Order 37, to wit, that the Rules apply only "in so far as they are not inconsistent with the Act or with these general orders," Rule 15(b) must yield to General Order 32.

POINT V

THE TESTIMONY OFFERED IN SUPPORT OF SPECIFICATION "1(b)" WAS INSUFFICIENT TO SUSTAIN THE SPECIFICATION

Specification "1(b)" prior to the amendment by order of the Referee in Bankruptcy, alleged the following:

> "(b) in contemplation of the bankruptcy proceeding of John Licht, Inc. knowingly transferred to himself property of John Licht, Inc., to wit: The bankrupt obtained coupons, points, premiums and/or merchandise stamps belonging to John Licht, Inc. and entitling it to various merchandise, and used same to his own benefit and account for the acquisition of, among other things, clothing, carpeting, living room furniture, dining room furniture, television, a typewriter, a stereo outfit, a bar and lamps without paying said corporation consideration therefor."

The Referee permitted the trustee to amend the specification by adding the word "fraudulently", so that the specification then read that the transfer was made in contemplation of bankruptcy "knowingly and fraudulently".

The facts upon which this specification was based, is accurately set forth in the opinion of the learned Referee in Bankruptcy, as follows:

"Two of The Corporations' suppliers, the Thermoid Division of the H. K. Porter Company, hereinafter Thermoid, and AC had sales promotion plans to increase the sales of their products. The AC plan had been in existence for about twenty years and The Thermoid plan for about five years prior to The Corporation's bankruptcy. Under these plans The Corporation could either earn points, premiums or coupons or purchase them at a discount, depending on the volume or type of business which it did with these suppliers. The points could then be redeemed for almost any type of merchandise through representatives designated by them. (S.M., June 9, 1972, pp. 5, 19-28). The value of these points or premiusm was not insubstantial. For the five year period prior to 1967 The Corporation received points valued at between $50,000 and $60,000 a year which were to be given to its sales employees or its customers to stimulate the sales of Thermoid and AC products. (S.M., June 16, 1972, p. 38; June 9, 1972, pp. 22-29).

Melvin admitted that he had taken points valued at $16,000 from The Corporation during the two year period prior to June 1, 1967 which were used by him in furnishing his home, for wearing apparel and other items. He admitted using the points to get a vacuum cleaner, furniture of various kinds, carpeting, linens, a camera, clothing for himself and his family, an electric built-in oven, a radio and stereo components in the period from January 16, 1966 through April 28, 1967. (S.M., June 9, 1972, pp. 5-19, 29-49; June 16, 1972, pp. 8-19 and Exhibits 1, 2, 3, 4, 5, 7, 11, 16, 17, 18, 19, 20, 21, 22 and 23)."
Referee's Opinion. (A 269, 270)

Although the Referee found that the bankrupt had taken points valued at $16,000.00 from the Corporation, during a two year period prior to June 1, 1967, he did not find the taking of these points was a fraudulent transfer in contemplation of bankruptcy, except for points which were used for stereo components and ordered by him on April 20 and April 28, 1967, which merchandise was of a minimal value in comparison to the total amount received by the bankrupt.

The Referee did not find the other items to have been transferred in contemplation of bankruptcy because this practice had been going on under the AC plan referred to by the Referee, for a period of twenty years and under the Thermoid plan, for about five years prior to the bankruptcy.

The bankrupt testified that during this extended period of time he was taking the points as additional compensation for the services rendered by him in view of his small salary of $150.00 a week.

There is no dispute that the bankrupt was the principal operating officer of the corporation and as such, was entitled to receive more than $150.00 a week.

He did not include this extra compensation in

his income tax return because he did not consider it income. He was later assessed approximately $3,000.00 by Internal Revenue Service as additional taxes for the points and coupons that he took as additional compensation and he is paying these additional taxes.

The Referee found that the stereo components ordered by the bankrupt on April 20 and 28, 1967, were ordered when the bankrupt contemplated that the corporation would file a bankruptcy proceeding. This finding is predicated primarily on a resolution of the Board of Directors of the corporation annexed to the petition for an arrangement filed by the corporation in this Court, in which it appeared that a meeting of the Board of Directors had been held on April 19, 1967 to authorize the filing of the petition for an arrangement by the corporation. (A 274)

The learned Referee was in error in using the petition for an arrangement filed by the corporation and the documents annexed thereto, since they had not been offered in evidence in these hearings and therefore they were improperly used. This resolution was attached to the petition for an arrangement filed by John Licht, Inc., a proceeding which was separate and apart from this proceeding.

The Referee having found that the bankrupt had

properly taken the points or coupons as additional compensation for a period of two years, without contemplating bankruptcy, he cannot consistently find that one item taken prior to the bankruptcy petition which was not filed until June 1, 1967, was taken in contemplation of bankruptcy.

It is obvious that the bankrupt considered these points additional compensation for his services and the Referee has inferentially so found in finding that except for one item, stereo components, the items taken were not taken in contemplation of bankruptcy.

The bankrupt's contentions are set forth in the Referee's opinion, as follows:

> "Melvin contends: First, that at the time he took the coupons from The Corporation in order to get the merchandise covered by the exhibits referred to above he did not expect it to go into a bankruptcy proceeding; that he was doing everything within his power to keep it going including factoring with Transamerica and the execution of guarantees by himself and his wife which resulted in the loss of their home so that these acts were no done 'in contemplation' of The Corporation's bankruptcy; Second, that the points were taken by him as 'additional compensation' for the services which he was rendering to The Corporation in view of his small salary of $150 per week and that he had made an arrangement with the Internal Revenue Service for the payment of additional income taxes on their value. (A 270)

In support of the first contention he testified, under questioning by his attorney:

'Q Mr. Licht, I show you Exhibits 1,2, 3,4,5,7,11,16,17,18,19,20,21,22, 23 and ask you to look at each of these exhibits and tell the Court, at the time you ordered the merchandise set forth on those exhibits did you as the general operating principal of John Licht, Inc., contemplate it going into a bankruptcy proceeding?

'A No. No, I did not contemplate it.

'Q Look at them all and carefully consider it before you answer.

'A At no time when I ordered these did I contemplate going into bankruptcy.'

Again, in that same transcript he testified as follows, at pages 127 and 128:

'Q Mr. Licht, was your wife liable for any obligations of John Licht, Inc. prior to the execution by her of the guarantee which is Bankrupt's Exhibit C?

'A No, she wasn't.

'Q Can you tell us wherein/ (sic) your mind in March of 1967, after you had obtained a ¶200,000 loan from Franklin Bank and a $400,000 loan from Transamerica, did you think that you would be able to continue your business and pay your debts?

'A Yes, I did.

'Q Did you at that time contemplate going into any bankruptcy proceeding?

'A None whatsoever.

'Q When was the first time that you considered bankruptcy at all?

'A The end of May, when I came to you and --

'Q That was the beginning of May.

'A Oh, beginning of May. I'm sorry.

'Q Yes.

'A The beginning of May. And your accountant came in and went over my books, which were far behind due to the illness of my accountant, and when I saw the true light we realized how bad things were.

'Q And prior to that time, you didn't know actually what your real financial condition was?

'A No, I did not.'"
Referee's Opinion (A 271, 272)

The testimony adduced by the trustee did not show that the bankrupt had made the transfer "knowingly and fraudulently". The testimony was clear that the practice of taking the points or premiums had been going on for a period of 20 years under one plan, and approximately 5 years, under the other.

Assuming that the bankrupt knew that the company would soon be in bankruptcy, the taking of the coupons or points by him was not done fraudulently, since this prac-

tice had been going on for all these years.

It has been held that the words "knowingly" and "fraudulently", are required to be given their natural significance.

> "*** A necessary element of the crime described in the statute is that the defendant knowingly and fraudulently conceal the property. United States v. Comstock, C.C., 162 F. 415; United States v. Rhodes, D.C., 212 F. 513. as used in the statute the adverbs 'knowingly' and 'fraudulently' must have their natural significance given to them. Klein v. Powell, 3 Cir., 174 F. 640.***"
> United States v. Yasser, 114 F.2d 558, (CCA 3d Cir.)

The Referee's order sustaining specification "1(b)" should be reversed upon the following grounds:

1. The trustee failed to prove that in contemplation of the bankruptcy proceeding of John Licht, Inc., knowingly and fraudulently transferred to himself property of John Licht, Inc., consisting of points, coupons, premiums and merchandise.

2. The Referee found that out of $16,000.00 worth of merchandise taken by the bankrupt over a two year period, only stereo components of a small value relative to the total amount was transferred knowingly and fraudu-

lently in contemplation of bankruptcy of the corporation. This finding was bottomed on the matters contained in the petition for an arrangement filed by John Licht, Inc., a different proceeding than the instant one. The learned Referee was in error in using the petition for an arrangement in a different proceeding, John Licht, Inc., as evidence, since it had never been offered in evidence at the hearings and was not a proper and legal exhibit.

Under all the circumstances, the Referee's finding that the trustee had sustained specification "1(b)" was in error. The Referee's order should be reversed and it should be found that the trustee failed to sustain specification "1(b)".

POINT VI

THE TESTIMONY OFFERED IN SUPPORT OF SPECIFICATION "2(g)" WAS INSUFFICIENT TO SUSTAIN THE SPECIFICATION

Specification "2(g)" originally alleged the following:

> "2. The bankrupt has committed an offense punishable by imprisonment as provided under Title 18, United States Code, Section 152, in that, in contemplation of the filing of the bankruptcy of John Licht, Inc., the bankrupt knowingly and fraudulently falsi-

fied or made a false entry in documents affecting or relating to the property or affairs of said John Licht, Inc., to wit:

***

(g) Entries were made in the books of John Licht, Inc. representing returns of merchandise to said Company, none of which was actually received by it."

These specifications were filed on March 6, 1970 and remained unchanged until after completion of the hearings and the submission of briefs.

Specification "2(g)" clearly alleges that the act complained of, to wit, entries made in the books of John Licht, Inc. representing returns of merchandise, were done or committed "in contemplation of bankruptcy".

At the hearings, proof which was offered, disclosed that these entries were made subsequent to the filing of the petition for an arrangement and no "in contemplation thereof".

Subsequent to the hearings and the submission of briefs, an application was made by the trustee to add a new specification in place of specification "2(g)", in which it was to be alleged that these entries were made "after the filing of a bankruptcy proceeding by John Licht, Inc. and in contemplation thereof".

This application was granted by the Referee and this question has already been discussed in Point III of this brief.

There was no proof offered on the hearings, by the trustee, that the acts complained of, to wit, "entries made in the books of John Licht, Inc. representing returns of merchandise to said company, none of which was actually received by it", were in contemplation of the bankruptcy proceeding.

The trustee therefore failed to sustain the specification which he set out to prove. The Referee should have found that the trustee failed to sustain specification "2(g)".

Specification "2(g)" as amended by authorization of the Referee, alleged that "after the filing of a bankruptcy proceeding by John Licht, Inc. and in contemplation thereof", the bankrupt knowingly and fraudulently falsified or made a false entry in the books of John Licht, Inc., representing returns of merchandise to said Company, none of which was actually received by it.

It is important to note the reason for the making of the alleged false entries.

The Referee's decision sets forth the facts

relating to these entries as follows:

> "The Corporation had been a large distributor of AC products for many years. This company had a system of rebates under which it gave its distributors an additional discount of 10%, over and above its regular discount, on merchandise which they sold to customers designated by it as wholesale accounts. The distributors, including The Corporation, were not restricted in their sales of AC products but they would not get the additional 10% discount on AC merchandise sold by them to non-designated accounts. (S.M., June 16, 1972, pp. 135-139; August 9, 1972, pp. 62-64)
>
> Many of The Corporation's customers were the so-called designated accounts, however, it sold a great deal of AC merchandise to non-designated accounts on which it would not be entitled to the additional discount. In order to get the extra 10% discount on these sales he would have The Corporation make out invoices to designated accounts for AC merchandise which would be sold to non-designated accounts by means of what he called 'pro-invoicing'. This was the creation of fictitious invoices to designated accounts prior to the receipt of the merchandise from AC. On receipt of the merchandise it was sold to non-designated accounts which were billed for it. The books of The Corporation would reflect the fictitious sales to the designated accounts while the actual sales would be entered on sheets of paper kept on a clipboard and when payment therefor was received it was credited to the designated accounts to which they had been charged. In this way, the sales to the non-designated accounts were concealed from the AC auditors who checked The

Corporation's books periodically (S.M., June 16, 1972, pp. 136-147; August 9, 1972, pp. 86-97). (A 265, 266)

This practice had been going on for over 40 years.

"Q During what period of time were these other invoices entered on the books and records of John Licht?

A Invoices of this type were entered on the books for about forty years that I was doing business with AC."
(A 190)

The bankrupt, subsequent to the filing of the Chapter XI proceeding, made entries in the books of John Licht, Inc., indicating that returns had been made by the customers who were listed as accounts receivable, but who had not received any of the merchandise.

These accounts receivable were usually cleared off the books within thirty days.

"Q How long did you carry a receivable like that on your books?

A Well, usually, when the merchandise was constantly being shipped in they usually were cleared off the books within thirty days."
(A 193)

The bankrupt's purpose in making entries of returns which were not received, was to clarify the records

so that claims would not be made against the customers who had not received the merchandise.

The Referee, in his findings of fact, found as follows:

"SPECIFICATIONS 2(a),(b),(c),(d) and (h)

31. For many years prior to its bankruptcy Melvin, in order to cover up the sales of AC merchandise to non-designated accounts and to get the 10% additional discount:

(a) Caused entries representing accounts receivable to be made in The Corporation's books and records for merchandise which was not sold by it.

(b) Caused invoices to be created for merchandise not sold or shipped by it.

(c) Caused invoices to be created for prices higher than the actual sales price of merchandise sold by it.

(d) Caused sales of merchandise of The Corporation to be made without proper invoices being created or proper entry being made as to the same in its books and records.

(h) Caused payments received by it to be credited to fictitious accounts" (A 292, 293)

However, the Referee found that these acts were not done in contemplation of the bankruptcy of John Licht, Inc.

"SPECIFICATION 2

3. All of the acts alleged in Specification 2(a), (b), (c), (d), (f), (h), and (i) were not done in contemplation of The Corporation's bankruptcy.

4. No proof was submitted to support Specification 2(e).

5. Specifications (2)(a), (b), (c), (d), (e), (f), (h) and (i) are dismissed." (A 295)

The basis of the Referee's finding must be that these were acts which had been done over the past 40 years and were therefore not done knowingly and fraudulently or in contemplation of bankruptcy.

Consistently, the same finding should be applied to specification "2(g)", since the making of an entry in the books of the corporation relating to returns, was part of the entire transaction.

The record is clear that there was no attempt by the bankrupt to conceal the fact that he had made the entries complained of. Immediately after adjudication and in July, 1967, the bankrupt testified fully and completely, about these transactions. (A 186)

OPINION OF DISTRICT COURT

Judge Costantino of the District Court, in his opinion, substantially followed the reasoning of the Referee in Bankruptcy.

The court below stated in connection with the merits of specification "1(b)" the following:

> "On the merits of the Referee's report concerning Specification 1(b), the critical issue presented, aside from the Referee's factual finding, was whether judicial notice could be taken of the file in a related bankruptcy proceeding. It is settled law that courts may judicially notice the records of prior litigation between the same parties before the same court. (Citing Cases)
> (A 305)

While the law is settled that courts may judicially notice the records of prior litigation between the same parties before the same court, in this case, the document used by the Referee, to wit, the petition in an arrangement proceeding, was used in a separate and completely different case, to wit, John Licht, Inc., and therefore the cases cited are not applicable.

CONCLUSION

The order made by the District Court should be reversed and a discharge granted:

1. The Court should not have permitted the trustee to amend specification "1(b)", which was insufficient as a matter of law, after all the testimony had been adduced, the hearings concluded and briefs submitted by the parties.

2. The evidence offered in support of specification "1(b)" as amended, was insufficient to sustain the specification.

3. The Court should not have permitted the trustee to add an entirely new and different specification in place of specification "2(g)", after all the testimony had been adduced, the hearings terminated and briefs submitted by all the parties.

4. The testimony offered in support of specification "2(g)" as amended, was insufficient to sustain specification.

The order of the District Court should be reversed and an order made granting the bankrupt his discharge in bankruptcy.

Respectfully Submitted,

MICHAEL BERMAN,
Attorney for Appellant.

U.S. COURT OF APPEALS:SECOND CIRCUIT

Index No.

LICHT,

Appellant,

against

ASH,

Appellee.

Affidavit of Personal Service

STATE OF NEW YORK, COUNTY OF NEW YORK *ss.:*

I, Victor Ortega, *being duly sworn,*

deposes and says that deponent is not a party to the action, is over 18 years of age and resides at

1027 Avenue St. John, Bronx, New York

That on the **28th** *day of* **June** *1974 at* **350 5th Avenue, New York**

deponent served the annexed Appellant's Brief *upon*

Hahn, Hessen, Margolis & Ryan-Attorneys for Appellee

the *in this action by delivering* 2 *true copy* Nos *thereof to said individual personally. Deponent knew the person so served to be the person mentioned and described in said papers as the* Attorney(s) *herein,*

Sworn to before me, this 28th *day of* **June** *19* 74

Victor Ortega

Print name beneath signature

VICTOR ORTEGA

Robert T. Brin

ROBERT T. BRIN
NOTARY PUBLIC, STATE OF NEW YORK
NO. 31 - 0418950
QUALIFIED IN NEW YORK COUNTY
COMMISSION EXPIRES MARCH 30, 1975